

Continuing Anti-Fraud Education for Procurement Professionals

Introduction

Training Overview

Anti-Fraud Basics

- Principles, terms and definitions

Procurement Fraud

- A Focus On Bid-Rigging; targets, red flags, controls and reporting
- Inherent Public Sector Risks
- Open government Historical Perspective and the Emergence of Transparency, Integrity and Competition as controls.
- Mitigating The Risks and Reporting Fraud

What Is Fraud? Source: Association of Certified Fraud Examiners

In the broadest sense, fraud can encompass any crime for gain that uses deception as its principal modus operandus. More specifically, *fraud* is defined by *Black's Law Dictionary* as:

*A knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment.*¹

Consequently, fraud includes any intentional or deliberate act to deprive another of property or money by guile, deception, or other unfair means.

External Fraud

Source: Association of Certified Fraud Examiners

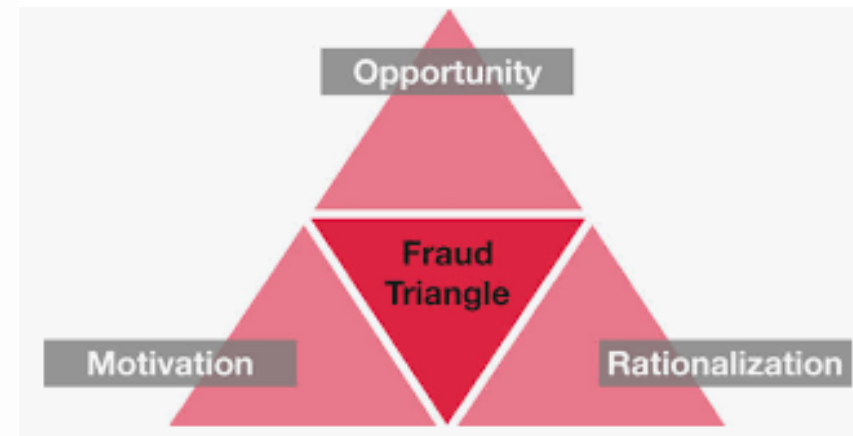
External fraud covers:

- Dishonest vendors that might
 - Engage in bid-rigging schemes
 - Bill the company for goods or services not provided
 - Demand bribes from employees.
 - Submit bad checks or falsified account information for payment
 - Attempt to return stolen or knock-off products for a refund.
- Also includes:
 - Security breaches and hacking.
 - Third party intellectual property theft.
 - Tax fraud, bankruptcy fraud, insurance fraud, healthcare fraud, and loan fraud.



Cressey's Fraud Triangle

All three components must be present at the same time for someone to commit fraud



The Fraud Triangle by Dr. David Cressey |

Think Like A Fraudster

Source: US Chief Financial Officers Council

Why is this important

Understanding the types of fraud that your agency is vulnerable to, both internal and external, is imperative to developing the right antifraud activities. “Thinking like a fraudster” and coming up with the *fraud schemes* that could be used to commit fraud at your agency is a vital step.

Professional Skepticism

Professional Skepticism Traits

Informed Ethical Persistent

Independent of Mind Perceptive

Effective Communication Skills

Able to Question Without Being Adversarial

Importance of Professional Skepticism

In many professions, adopting a skeptical mindset helps an individual more effectively fulfill his duties. Scientists, teachers, investigators, doctors, auditors—anyone who must collect and assess information as part of their job—all benefit from applying reason and critical analysis in their search for a factually supported conclusion.



It is within this view that skepticism provides value to professional duties. In practice, skepticism involves a *search for the truth* by:

- ❑ Applying reason to determine the validity of a claim
- ❑ Critically analyzing all evidence received
- ❑ Finding a factually supported conclusion, not the justification of a preconceived conclusion

Skeptic does not mean him who doubts, but him who investigates or researches as opposed to him who asserts and thinks that he has found.

What is bid-rigging and why is it bad?

Tailoring bidding to favor one vendor

To promote genuine competition the evaluation of bids should be:

- Under the same terms and conditions
- Free from bias and independently
- On their merits based on how they meet specifications

Overall Objective:

- To procure products and services for the state at the best value.

Potential Targets

Anyone with authority over the contract awards such as:

Buyers

Contracting officials

Engineers and technical representatives

Quality or product assurance representatives

Subcontractor liaison employees

Anyone with authority over the contract awards

Procurement managers

Specification writers



Bid-Rigging Schemes & Phases

Phase I: Pre-Solicitation

Phase II: Solicitation

Phase III: Submission

Phase I: Pre-Solicitation

Need recognition scheme

An employee is paid to convince their agency a project is necessary causing the victim company purchases unnecessary goods or services.

Specification scheme

The contract is tailored to the strengths of a particular supplier or the specifications of the contract accommodate the vendor's capabilities.

Phase II: Solicitation

Influencing selection by restricting the pool of competitors to improve the chances of winning

Bid Pooling, Bid Rotation and Bid Splitting:

Pooling: Bidders conspire to split up contracts, to guarantee that each vendor wins a share of the purchasing company's business and may conspire to raise their prices. Also known as a "market allocation scheme"

Rotation: Colluding vendors agree to take turns submitting the winning (lowest) bid.

Splitting: A company pays an employee to split a contract into small dollar amounts that do not require a formal bid. The employee is given a kickback for circumventing the bidding process and giving the contract to the vendor.

Complementary Bidding, Suppression and Price Fixing:

Vendors collude to rig pricing to their mutual benefit, refrain from submitting bids or maintain, raise or fix prices at artificially inflated prices.

Phase II: Solicitation (continued)

Influencing selection by restricting the pool of competitors to improve the chances of winning

Fictitious suppliers:

Quotes from fictitious organizations are used to demonstrate competitive pricing and/or validate inflated pricing.

Time advantages and scope of solicitations:

Restricting the time for submitting bids or providing advance notice of contracts can also be used provide an advantage over the competition.

Bids may be solicited in obscure publications or during holiday periods so some vendors are unlikely to see them.

Bids may be accepted but “lost” or improperly disqualified by the corrupt employee of the purchaser.

Phase III: Submission

Those with access to sealed bids are often the targets of unethical vendors.

Some vendors pay to submit their bid last, either already knowing what others bid or to see competitors' bids and adjust their own bid accordingly.

The Perfect Storm

Characteristics That Support Bid-Rigging

Industry sectors
most vulnerable to
bid-rigging fraud

Colluding parties must agree to and enforce a common course of action making some economic sectors more vulnerable to bid rigging than others

Small number of companies

Bid rigging is more likely to occur when a small number of companies supply the good or service. Collusion in any context is easier the few parties involved.

Little or no entry

Businesses in markets that are costly, hard or slow to enter with few new entrants and little competitive pressure. This environment is conducive to collusion and bid-rigging.

Market conditions and Industry associations

A predictable flow of demand increases the risk of collusion by stabilizing ongoing bid-rigging agreements but periods of economic upheaval or uncertainty provides incentives for competitors to rig bids as they replace lost business.

Industry associations can promote standards, innovation and competition. However, these associations have been used by company officials to conceal bid rigging agreements.

Industry sectors
most vulnerable to
bid-rigging fraud
(continued)

Repetitive bidding

Repetitive purchases increase the chances of collusion so goods or services that are regular and recurring may require special tools and vigilance to discourage collusive tendering.

Similar products or services, few substitutes and little/no technological change

Similar products or services helps facilitate a common price structure.

Few alternative products or services, supports collusion to raise prices.

The absence of disruptive technology provides stability that helps maintain big-rigging agreements over time.

Elevated Risk in the Public Sector

- ✓ Look for “red flag” warning signs and fraud patterns
- ✓ Check all documents for signs of conspiracy and collusion
- ✓ Pay attention to pricing and suspicious statements
- ✓ Don’t ignore peculiar or suspicious patterns of behavior.

Be vigilant

Employ professional skepticism




Anti-Fraud Procurement Checklist

- ✓ Be Informed about the market, products and services.
- ✓ Maximize the pool of genuine competitive bidders.
- ✓ Define clear requirements and avoid predictability.
- ✓ Ensure communication among bidders is permitted.
- ✓ “Fraud-Proof” the award criteria and evaluation.
- ✓ Raise fraud awareness and educate staff about bid rigging.



Mitigating the Risk

“Fraud-Proofing” the
Procurement Process



Overarching Anti-Fraud Principles

Transparency

Integrity (Data and Processes)

Competition

An abstract orange splash graphic on the left side of the slide, with a darker orange area at the bottom and lighter orange areas at the top and right, creating a sense of movement and depth.

Open Government Historical Background

Legislation that lead to the Public Information Act was motivated by the 1969 Sharpstown fraud scandal.

Houston business man Sharp granted \$600,000 in loans from Sharpstown State Bank to the state officials to buy National Bankers Life stock which were resold at huge profits, as Sharp artificially inflated the value of his insurance company's stock.

In return Sharp benefited from the passage of new state bank deposit insurance legislation.

The Sarbanes-Oxley Act and Corporate Fraud



BY ROSEMARY PEAVLER • Updated August 16, 2018

The Sarbanes-Oxley Act is a federal law that enacted a comprehensive reform of business financial practices. The 2002 Sarbanes-Oxley Act aims at publicly held corporations, their internal financial controls, and their financial reporting audit procedures as performed by external auditing firms.

The act was passed in response to a number of corporate accounting scandals that occurred in the 2000–2002 period. This act, put into place in response to widespread fraud at Enron and other companies, set new standards for [public accounting firms](#), corporate management, and [corporate boards of directors](#).



already collecting under existing financial laws, data analytics could catch fraudsters and inform better decisions.”

– Representative Randy Hultgren (R-IL)

“Bernie Madoff was able to fool financial regulators because they are still using 1930s pen and paper technology to handle today’s digital challenges. If the regulators adopted standardized data fields and formats across the information they are

U.S. Securities and Exchange Commission

The Securities and Exchange Commission Post-Madoff Reforms

- [Revitalizing the Enforcement Division](#)
- [Revamping the handling of complaints and tips](#)
- [Encouraging greater cooperation by 'insiders'](#)
- [Enhancing safeguards for investors' assets](#)
- [Improving risk assessment capabilities](#)
- [Conducting risk-based examinations of financial firms](#)
- [Improving fraud detection procedures for examiners](#)
- [Recruiting staff with specialized experience](#)
- [Expanding and targeting training](#)
- [Improving internal controls](#)
- [Advocating for a whistleblower program](#)
- [Seeking more resources](#)
- [Integrating broker-dealer and investment adviser examinations](#)
- [Enhancing the licensing, education and oversight regime for 'back-office' personnel](#)



Mitigating the Risk

“Fraud-Proofing” the
Procurement Process

Mitigating the Risk: Restrictions & Disclosures

Source: Texas Procurement and Contract
Management Guide version 1.1 June 2018

State Employee Restrictions:

A state agency may not contract with a private vendor if the amount of the PO exceeds \$25,000 and any of the following agency have a financial interest in the vendor:

Member of a state agency's governing body,

Governing official, executive director, general counsel, chief procurement officer, or procurement director; or

Family member related to one of the persons is within the second degree of kinship by affinity or consanguinity.

Mitigating the Risk: Restrictions & Disclosures

Source: Texas Procurement and Contract
Management Guide version 1.1 June 2018

What is a “Financial Interest”?

An ownership or controlling interest directly or indirectly, of at least 1%, including the right to share in profits, proceeds, or capital gains or

If it is reasonably foreseeable that a contract could result in a financial benefit to the employee or official



Mitigating the Risk: Restrictions & Disclosures

Source: Texas Procurement and Contract
Management Guide version 1.1 June 2018

State Officer Restrictions

A state officer may not solicit or accept from a governmental entity a commission fee, bonus, retainer, or rebate as compensation for the officer's personal solicitation for the award of a contract for services or sale of goods to a government entity.

This prohibition does not apply to a court appointment or a contract that is awarded to the state officer by competitive bid as provided by law and that is not otherwise prohibited by law

Mitigating the Risk: Restrictions & Disclosures

Source: Texas Procurement and Contract
Management Guide version 1.1 June 2018

Procurement Professional Disclosures

State agency procurement employees or officials shall disclose any known or potential conflict of interest, if the PO exceeds \$25,000.

SAO Disclosure Statement

Agency purchasing personnel working on a contract over \$1M must disclose any relationship with an employee, a partner, a major stockholder, a paid consultant with a contract with the business entity the value of which exceeds \$25,000, or other owner of the business entity that is within the degree of kinship.



Mitigating the Risk: Restrictions & Disclosures

Source: Texas Procurement and Contract
Management Guide version 1.1 June 2018

Interested Parties Disclosure Statement

If the state contracts with an entity that requires an action or vote by a governing body before the contract is signed or if the value is over \$1M an interested party disclosure statement is required

An interested party is somebody with a *controlling interest* in a business entity with whom a governmental entity or state agency contracts or who *actively participates in facilitating the contract or negotiating the terms of the contract*, including; a broker, intermediary, adviser, or attorney for the business entity



Mitigating the Risk: Pre-Solicitation

Source: Texas Procurement and Contract
Management Guide version 1.1 June 2018

Vendor Communication Rules

Pre-contract vendor contact is permitted but subject to advanced scrutiny to maintain a “level playing field. If in doubt consult with legal counsel.

Pre-contract exchange of information is permitted but shouldn’t only involve the incumbent or a few vendors and must not produce specifications that favor one vendor. If a vendor is paid they are ineligible to bid.

Vendor communication must cease when solicitation-drafting has begun.

Mitigating the Risk: Solicitation

Source: Texas Procurement and
Contract Management Guide version
1.1 June 2018

Vendor Communication Rules

Vendor specification inquiries should go through designated agency contacts and a Q&A process.

Any procurement relevant information provided to vendors must be publicly released without delay.

Response to award contact includes clarifying how to meet requirements, permitted negotiations (BAFO) and information exchanges necessary to award.

Evaluation must only be based on formal correspondence and submitted documentation.

If one vendor is able to clarify their response, all must be.



Mitigating the Risk: Fostering Competition

Source: Texas Procurement and Contract
Management Guide version 1.1 June 2018

Restrictive specifications

Product or service must not be customized in specifications, whether the specification is performance or design-based or mixed.

Scope of Work

Established standards define performance deliverables and milestones.



Mitigating the Risk: Transparency and an Even-Playing-Field

Source: Texas Procurement and Contract
Management Guide version 1.1 June 2018

Publication of Evaluation Criteria


- Solicitation must identify the criteria and corresponding weight.

- However, agencies may detail how each criterion is broken down and even provide copy of the evaluation scoring sheets.

Protests

- May be filed if published evaluation criteria are not adhered to or criteria not in the solicitation is used to rank or select responses.

- For example, additional points for a national accreditation must be in the solicitation so all respondents have an opportunity to score higher. If not in the solicitation, respondents without it cannot be penalized



Mitigating the Risk: Oversight

Source: Texas Procurement and
Contract Management Guide
version 1.1 June 2018

The Contract Advisory Team

- Reviews solicitation documents for contracts over \$5M.

- Reviews state auditor findings or recommendations

- Develops “best value” policies and procedures to improve agency contract management and contracting practices.

- Assesses risk to determine appropriate oversight.

Quality Assurance Team

- Approves contracts related to major projects valued at more than \$10M and contract amendments over 10 percent of original value.

- Implements standard, repeatable, predictable, and transparent QA.

Mitigating the Risk: Oversight

Source: Texas Procurement and
Contract Management Guide version
1.1 June 2018

The State Auditor's Office (SAO)

Investigates allegations of FWA and co-ordinates with internal auditors, federal and state prosecutors, and city, county, state, and federal law enforcement agencies.

Reports of FWA involving state resources may be submitted through:

The SAO website,

By phone at 1-800-TX-AUDIT (892-8348), or

By mail to State Auditor's Office, Attn: IAS, P.O. Box 12067, Austin, TX 78711-2067.

Note: Someone reporting fraud may choose to remain anonymous

Reporting Fraud, Waste or Abuse

Source: Texas Procurement and Contract Management Guide version 1.1 June 2018

Each agency must assess FWB risk in the contracting process, contract provisions, and payment and reimbursement rates and methods.

Administrative heads of agencies with “reasonable cause” to believe money was lost, misappropriated, or misused, or other fraudulent or unlawful conduct has occurred must report this to the SAO.

Reasonable cause: when a set of facts lead a reasonable and prudent person to believe an offense may have been committed

Employees and vendors who become aware of suspicious activities or fraudulent acts may also report the allegations to SAO.

Where should I report a bid-rigging scheme?

Begin with your supervisor and division head

Then formally report internally using established channels

Report externally

Comptroller's Office Contacts

Internal Audit, Cheryl Scott, 512-46(3-4894)

Ethics Officer, Carol McCord, 512-93(6-8485)

Network, an anonymous reporting hotline: 866-420-8369

State Auditor's Office (SAO)

SAO Fraud Hotline: 1-800-TX-AUDIT

SAO Fraud Website: <http://sao.fraud.state.tx.us/>

Questions:

